New Rules for Options on Shares in Limited Liability Companies

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From now on, an option holder can realize a put or call option for shares in a Russian limited liability company (LLC) without the participation of the other party. In this case, the notary sends the documents for the sale / purchase of shares in the LLC for the registration in the Federal Tax Service and the acceptance – to the offeror.

This solves a serious practical problem, when after the acceptance (in other words, after the conclusion of the contract), the offeror diverges from the visit to the notary to register the transfer of title to the shares.

Details – in the newsletter of Mosgo & Partners.

1. BACKGROUND

A separate article in the Russian Civil Code (**CC**) regarding the options on the conclusion of the contract was enacted shortly before the amendments to the LLC Law. Even though options were used in practice before that, they were risky to the parties: options were not stipulated by law. Article 429.2 of the CC defines an option as an agreement on issuance of an irrevocable offer to conclude a contract in the future.

Options give substantially more freedom to corporate relations, such as:

- shareholder agreements;
- complex M&A deals;
- resolving deadlocks.

Simultaneously, the Russian law sets forth the mandatory notarial form for LLC share deals. Parties traditionally **sign contracts on the sale and purchase of shares in the presence of the notary**.

Correspondently, before the amendments to the LLC Law entered into force, options were hardly applicable to the transactions with shares in the charter capital of limited liability companies. If the offeror diverged from the visit to the notary after the acceptance, the only way out was to file a lawsuit.

2. NEW PROCEDURE

The Federal law dated 29.12.2015 No. 391-FZ introduced changes to para. 11 art. 21 of the LLC Law, which should make options on shares in LLCs more efficient.

The law sets forth the following procedure:

- first, the **irrevocable offer must be notarized** (alternatively, the agreement on issuing the irrevocable offer is notarized);
- further, the offeree exercises the right under the option **by notarizing the acceptance**;
- then, the notary sends the acceptance to the offeror and **transmits a set of documents to the Federal Tax Service** for the registration of the transfer of rights to the shares (within 2 working days).

This way a serious practical problem is resolved, when the offeror diverges from visiting a notary to register the transfer of title to the shares after the offeree accepted the offer (and concluded the contract). As the presence of the offeror is not necessary on the second and third stages, the offeree can be sure that he can get the rights to the shares transferred easy and fast, and in accordance with the contract.

The seller of the option will not be able to diverge from the conclusion of the contract and the registration of the transfer of rights to the shares, if the offer or the agreement on the sale of the option is notarized.

By implication of law, the new procedure is applicable to both call options (the offeree has the right to buy shares from the offeror) and put options (the offeree has the right to sell shares to the offeror).

An irrevocable offer is deemed accepted as of the notarial certification of the acceptance. The transfer of shares is deemed completed as of the respective changes to the Unified State Register of Legal Entities.

3. RISKS

The use of options in regard of LLC shares can nevertheless entail some risks, *e.g.*:

- **Denial to notarize the acceptance.** The time gap between the offer and the acceptance, especially provided that each of them can be notarized by different notaries, as well as the unilateral nature of the acceptance increase the notary's responsibility in examining the documents and may lead to the denial to notarize the acceptance.

- **Proving the occurrence of a condition.** If the offer contains a condition precedent or a condition subsequent, the notary must evaluate the evidence of its occurrence (non-occurrence). Absent well-established practice and clarifications of the notary association, at

the beginning notaries can deny notarizing the acceptance.

- **Offeror's appeals.** The risk of appeals (challenging of a transaction) against the transfer of rights to the shares increases, if rights under the options are exercised in conflict situations.

Despite these risks, the new procedure provides significant protection to the parties to the agreement on the sale of option and, in our view, will become a useful tool in M&A transactions.

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